Report

of the

Examination of

Fortis Insurance Company

Milwaukee, Wisconsin

As of December 31, 2003

TABLE OF CONTENTS

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

November 12, 2004

Honorable Jorge Gomez
Secretary, Midwestern Zone, NAIC

Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Honorable Alfred W. Gross
Chair, Financial Condition (E) Committee, NAIC
Commissioner of Insurance
Commonwealth of Virginia
1300 East Main Street
Richmond, Virginia 23219

Honorable Julianne M. Bowler
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
Commonwealth of Massachusetts
One South Station, 5th Floor
Boston, Massachusetts 02110-2208

Honorable John Morrison
Secretary, Western Zone, NAIC
Commissioner of Insurance
State of Montana
840 Helena Avenue
Helena, Montana 59601

Honorable Walter A. Bell
Secretary, Southeastern Zone, NAIC
Commissioner of Insurance
State of Alabama
201 Monroe Street, Suite 1700
Montgomery, AL 36104

Commissioners:

In accordance with the instructions of the Wisconsin Commissioner of Insurance, a compliance examination has been made of the affairs and financial condition of:

FORTIS INSURANCE COMPANY
Milwaukee, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Fortis Insurance Company (FIC or the company) was conducted in 2000 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2003, and included a review of such 2004 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's aggregate accident and health reserves and evaluated asset adequacy analysis. The results of the actuary's work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

Fortis Insurance Company is a Wisconsin-domiciled stock life insurance company. FIC was incorporated in Wisconsin on February 11, 1910, under the name Time Insurance Company. Effective April 1, 1998, Time Insurance Company changed its name to Fortis Insurance Company, the name presently used by the company.

In April 1969, Time Holdings, Inc., was established to serve as the non-operating holding company parent of Time Insurance Company and other direct and indirectly owned financial services operating subsidiaries. During 1978, control of Time Holdings, Inc., was acquired by N.V. AMEV, a large Dutch insurer. Subsequent acquisitions and mergers of N.V. AMEV with other European insurance and banking companies established Fortis, an international financial services holding company which holds a majority ultimate controlling ownership interest in Fortis Insurance Company. Ownership interest of the Fortis enterprise is jointly held by Fortis N.V., a corporation domiciled in the Netherlands, and Fortis S.A./N.V., a corporation domiciled in Belgium. Fortis N.V. and Fortis S.A./N.V. are diversified international insurance, banking, and investment companies that have merged their subsidiary operating companies under the trade name Fortis.

As of December 31, 2003, the company's direct U.S. parent, Interfinancial, Inc., was a subsidiary of Fortis, Inc. (n/k/a Assurant, Inc.). Fortis, Inc., was a wholly owned U.S. holding company subsidiary of Fortis Insurance N.V., an insurance holding company jointly owned indirectly by Fortis N.V. and Fortis S.A./N.V. Fortis, Inc., established Assurant, Inc., as a Delaware corporation and merged into Assurant, Inc., effective February 4, 2004. As a result of the merger, Assurant, Inc., is the successor U.S. holding company to the business operations of Fortis, Inc. Effective February 5, 2004, an initial public offering of the common stock of Assurant, Inc., was transacted on the New York Stock Exchange. Subsequent to the 2004 IPO, the ownership interest of Assurant, Inc., held by Fortis Insurance N.V. decreased to approximately 35% of Assurant, Inc.'s outstanding common capital stock, with the remaining 65% ownership of Assurant, Inc., held by other diverse investors.

Prior to March 1999, FIC held 100% ownership interest in two subsidiary insurers, Fortis Benefits Insurance Company (FBIC) and United Family Life Insurance Company (UFLIC). Effective March 31, 1999, the company dividended FBIC and UFLIC to Interfinancial, Inc.. Effective August 11, 2004, the company established the Wisconsin-domiciled subsidiary National Insurance Institute, LLC (NII).

As is summarized above, Fortis Insurance Company is a member of a holding company system. Some of the company's business operations are performed by holding company affiliates pursuant to intercompany services agreements. Further discussion of the holding company organization, description of the company's significant affiliates, and description of the company's intercompany agreements are included in the section of this report captioned "Affiliated Companies."

In 2003 the company wrote direct premiums in the following states:

Texas	$ 133,252,099	10.5%
Illinois	112,229,079	8.9
Florida	73,876,507	5.8
Minnesota	64,020,736	5.0
Michigan	61,441,650	4.9
All others	823,215,484	64.9
Total	$1,268,035,555	100.0%

Fortis Insurance Company is licensed in the District of Columbia and in all state jurisdictions except New York and Hawaii.

The company's primary business is the issuance of accident and health insurance, and its business segment focus is individual and small employer group insurance. The company's individual health products are primarily for annually renewable major medical coverages. Most of the company's individual health products are Preferred Provider Organization plans which enable the insured to elect any health care provider and provide for higher benefit reimbursements when health care is rendered by a participating network provider. The company offers a Medical Savings Account feature for its individual health products whereby insureds may participate in a tax-sheltered savings account to fund insured's payment of medical expenses including coverage co-payments and deductibles. The company also markets short-term medical insurance for persons who require interim health coverage, and student health coverages sold to full-time college students.

The company's small employer group products are marketed primarily to groups of from two to fifty employees. The average group size as of year-end 2003 was five employees. Almost all of the current group benefit policies are PPO plans, and offer a package of employee benefits programs including group medical, group life, group AD&D, group dental, and group short-term disability.

The company markets through a regional sales distribution system using independent agents throughout the company's territory. Individual medical products are also marketed through national accounts relationships and through direct distribution channels. In 2000 the company became party to an exclusive national marketing agreement with Insurance Placement Service, Inc. (IPSI), a wholly owned subsidiary of State Farm Mutual Automobile Insurance Company. IPSI employs a captive agent sales force and offers company individual health insurance products.

The following chart is a summary of the premium income reported by the company in 2003. The growth of the company is discussed in the "Financial Data" section of this report.

2003 Premium Income

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Whole life	$ 6,602,492	$ 467	$ 6,747,148	$ (144,189)
Universal life	53,869,790		53,854,726	15,064
Immediate annuities	800,865		800,865	
Individual deferred annuities	408,243		408,243	
Credit life	422,803		422,803	
Group life	3,805,162	2,881	566,047	3,241,996
Group A&H	683,540,268	915,806	343,722,488	340,733,586
Credit A&H	(241,560)		(241,560)	
Other A&H	531,943,264	1,880,568	317,639,325	216,184,507
Total All Lines	$1,281,151,327	$2,799,722	$723,920,085	$560,030,964

III. MANAGEMENT AND CONTROL

Board of Directors

The FIC board of directors consists of three members. Each of the directors is elected annually to serve a one-year term. Officers are elected by the directors at the board's annual meeting. Each member of the company's board of directors is an employee within the Assurant, Inc., enterprise, and may also be a member of other boards of directors in the holding company group. The FIC directors do not receive specific compensation or reimbursement for serving on the board of Fortis Insurance Company.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
J. Kerry Clayton Summit, NJ	President and CEO Assurant, Inc.	2005
Robert B. Pollock New York, NY	Executive Vice President and CFO Assurant, Inc.	2005
Donald G. Hamm, Jr. Mequon, WI	President and CEO Assurant Health	2005

Officers of the Company

The executive officers of Fortis Insurance Company serving at the time of this examination are listed below. Each officer of the company is a direct employee of Fortis Insurance Company, and his or her annual employment compensation is remitted by the company.

Name	Office	2003 Compensation
Donald G. Hamm, Jr.	President and Chief Executive Officer	$526,689
Christina R. Palme-Krizak	Sr. VP, Secretary, and General Counsel	*
Howard C. Miller	Sr. VP, CFO and Treasurer	371,655
Stephen M. Arnhold	Vice President and Appointed Actuary	201,742

* Ms. Palme-Krizak was appointed to the office of Secretary in 2004. She was not employed by FIC prior to 2004 and was not subject to FIC employment compensation in 2003.

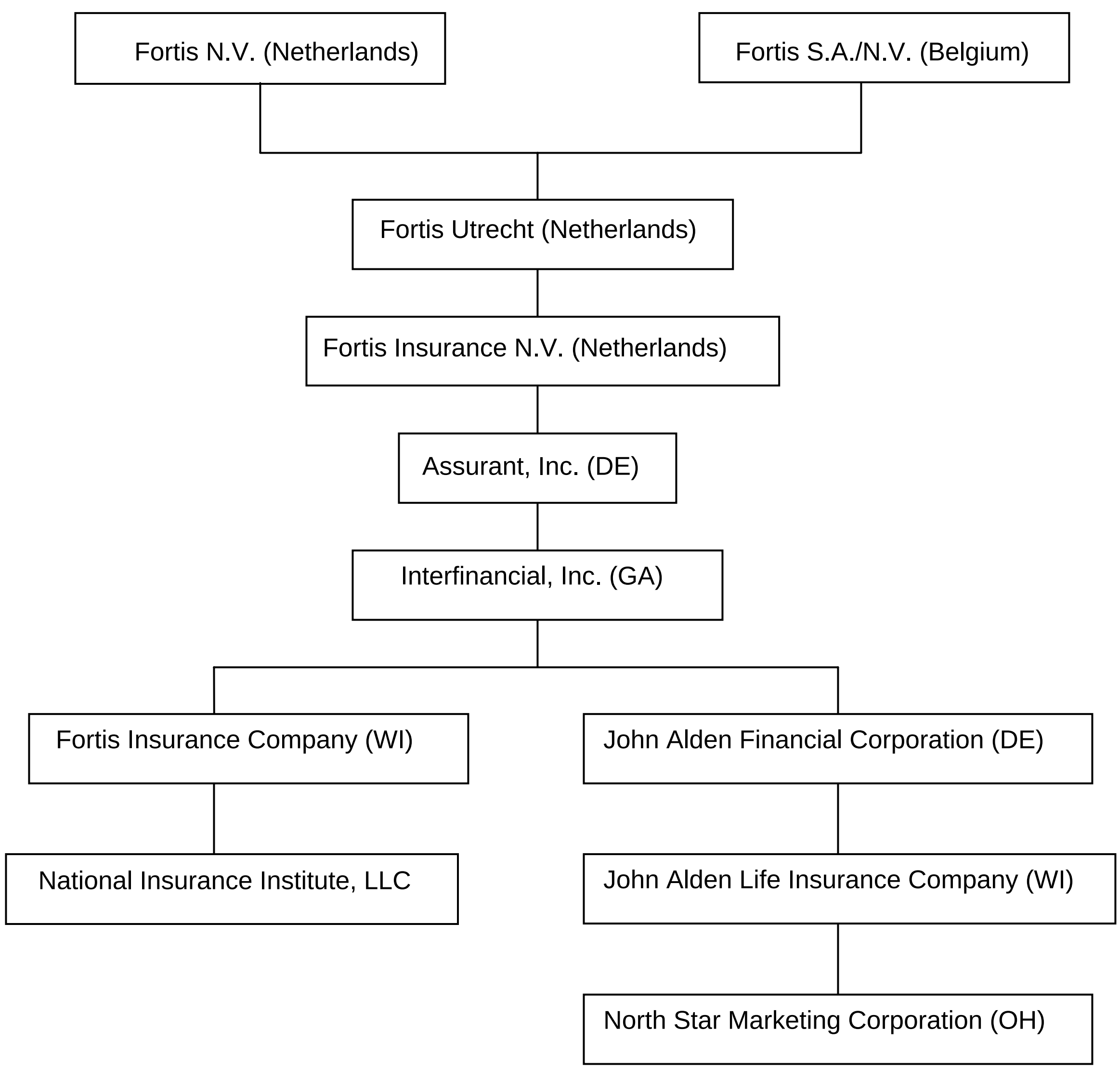
Committees of the Board

The company's bylaws authorize the formation of certain committees by the board of directors. The company has not established any committees of the board of directors at the time of the examination.

IV. AFFILIATED COMPANIES

Fortis Insurance Company is a member of a holding company system. The organizational chart below depicts the present relationships among the affiliates in the group. A brief description of significant affiliates follows the organizational chart.

Fortis Insurance Company
Organizational Chart



Fortis N.V. and Fortis S.A./N.V. (Fortis)

Fortis N.V. is a limited-liability corporation domiciled in the Netherlands, and Fortis S.A./N.V. is a limited-liability corporation domiciled in Belgium. Fortis N.V. and Fortis S.A./N.V. are diversified international financial services companies that have combined their operating companies under the trade name Fortis. The group's banking operations are conducted through Fortis Bank S.A./N.V., and insurance operations are conducted through Fortis Insurance Holding N.V.

In 2001 the ownership shares of Fortis N.V. and Fortis S.A./N.V. were merged into a single publicly traded Fortis share. Each holder of a Fortis share is a shareholder of both Fortis N.V. and Fortis S.A./N.V., and has the right to vote at the meetings of shareholders of both companies. Each Fortis shareholder may elect to receive either a Fortis N.V. or a Fortis S.A./N.V. dividend. The Fortis group is an international provider of insurance, banking, and investment products and services.

The following are summarized financial data from the Fortis consolidated financial statements as of December 31, 2003 (in millions Eurodollars and U.S. dollars):

	EUR	USD
Net Profit	2,197.4	$ 1,750.7
Total Assets	523,250.0	416,873.3
Total Liabilities	507,026.0	403,947.6
Risk-bearing Capital	16,224.0	12,925.7
Net Equity	11,894.2	9,476.1

(Revenue by business segment)

	EUR	USD
Total Revenue – Insurance	22,698.2	$18,083.7
Net profit – Insurance	897.5	715
Net Revenues – Banking	7,783.7	6,979.6
Net profit – Banking	1,495.2	1,191.2

(Conversion rate at 12/31/03 – 1 EUR = USD 0.7967)

Fortis Insurance Holding N.V.

Fortis Insurance Holding N.V. is domiciled in the Netherlands and serves as an intermediate holding company, existing solely for the purpose of holding operating insurance subsidiaries within the Fortis group. Effective December 31, 2003, Fortis Insurance Holding N.V. owned 100% of the common stock of Fortis, Inc. Subsequent to the 2004 merger of Fortis, Inc., into Assurant, Inc., and the issuance of public shares of Assurant, Inc., common stock, the ownership interest of Fortis Insurance Holding N.V. in Assurant, Inc., decreased to approximately 35% interest.

Assurant, Inc. (f/k/a Fortis, Inc., as of December 31, 2003)

Assurant, Inc., is a Delaware-domiciled holding company and is the ultimate U.S.-domiciled parent of Fortis Insurance Company. Fortis, Inc., the predecessor of Assurant, Inc., established and merged into Assurant, Inc., in February 2004. Assurant, Inc., transacted an initial public offering of its common stock on the New York Stock Exchange on February 5, 2004. As a result of the IPO, approximately 35% of the ownership interest of Assurant, Inc., is retained by the European-domiciled Fortis holding company, and the remaining 65% ownership interest is held by other Assurant, Inc., investors.

Assurant, Inc., serves as the parent company for the Fortis group's U.S. operations. Assurant, Inc., is an insurance and financial services holding company that through its subsidiaries operates in five decentralized operating business segments, including the Assurant Health, Assurant Employee Benefits, Assurant Solutions, Assurant PreNeed, and Corporate Operations business units.

As of December 31, 2003, the consolidated GAAP basis audited financial statements of Assurant, Inc., reported total assets of $23.7 billion, total liabilities of $21.1 billion, and total stockholders equity of $2.6 billion. Operations for 2003 produced net income of $185.7 million.

Interfinancial, Inc.

Interfinancial, Inc., is incorporated under the laws of the state of Georgia, and is the direct parent of Fortis Insurance Company, John Alden Life Insurance Company, and Fortis Benefits Insurance Company. Interfinancial, Inc., is a wholly owned intermediate holding company within the Assurant, Inc., organization, and does not have profit or loss activity.

John Alden Life Insurance Company (JALIC)

JALIC is a Wisconsin-domiciled life insurer that was initially organized in 1961 as an Illinois-domiciled insurer. JALIC redomiciled to Minnesota in 1973, and subsequently redomiciled to Wisconsin effective July 15, 2002. JALIC was acquired by Assurant, Inc., effective August 31, 1998. JALIC executed a statutory merger through which JALIC's then immediate parent, Houston National Life Insurance Company, merged with and into JALIC effective July 1, 2003. JALIC is an insurer within the Assurant Health business segment, and its primary business is the sale of small group medical and individual medical insurance coverages through a network of independent agents. JALIC is licensed in the District of Columbia, in all state jurisdictions except New York, and in Guam, the U.S. Virgin Islands, and Canada. JALIC is subject to a financial examination report prepared as of December 31, 2003, issued concurrently with this examination report of FIC.

As of December 31, 2003, the statutory basis audited financial statements of JALIC reported total admitted assets of $669,547,131, total liabilities of $535,375,566, and total policyholders surplus of $134,171,565. Operations for 2003 produced net income of $40,762,528.

Fortis Benefits Insurance Company (FBIC)

FBIC is an Iowa-domiciled life insurance company, and was originally incorporated in 1910 in Minnesota. FBIC redomiciled from Minnesota to Iowa on October 1, 2004. FBIC is the lead insurer in the Assurant Employee Benefits business segment, and its principal business focus is the provision of group employee benefit and individual pre-need products. FBIC is a major provider of group dental benefit plans sponsored by employers, and also provides disability and term life products and services to small- and medium-sized employer groups. FBIC is licensed in the District of Columbia, in all state jurisdictions except New York, and in Canada.

As of December 31, 2003, the statutory basis audited financial statements of FBIC reported total admitted assets of $8,011,166,460, total liabilities of $7,450,270,359, and total policyholders surplus of $560,896,101. Operations for 2003 produced net income of $121,896,422.

Agreements with Affiliates

The company has entered into various intercompany agreements for the provision of investment management services, business operations services, and income tax allocation. The intercompany agreements of the company are described below.

<u>Federal Income Tax Allocation Agreement</u>

The company participates in a Federal income tax allocation agreement between and among Assurant, Inc., and its affiliates. The agreement provides for the allocation of federal income taxes in accordance with provisions of Treasury Regulations s. 1.1552-1 and s. 1.1502-33, whereby the aggregate tax liability of the Assurant, Inc., group is allocated to the member companies on a separate company income tax return basis. Settlements for tax liability under the allocation agreement are to be made within 30 days of the Assurant, Inc., filing of the actual consolidated federal corporate income tax return with the Internal Revenue Service. In the event that a refund is due to the combined group, Assurant, Inc., may defer payment to the other members of the group for a period not to exceed 30 days from Assurant, Inc.'s receipt of such refund.

Investment Management Agreement

The company and Assurant, Inc., maintain an agreement under which Assurant, Inc., provides to the company investment management services for the maintenance and administration of the company's investment portfolio. Services provided by Assurant, Inc., include the following:

(a) General investment advice.
(b) Investment accounting.
(c) Establishment of company brokerage and custodial accounts and other arrangements for trading and safekeeping.
(d) Performance of all other functions necessary to manage the investment portfolio and to assist the company in its development of investment strategy.

The agreement provides that investment management services performed by Assurant, Inc., must conform to the company's investment guidelines and to applicable regulatory guidelines. The company pays an annual fee for services based on the market value of the investment portfolio as of June 30 of the immediately preceding year. All expenses related to Assurant, Inc., management of the company's investment portfolio, including brokerage fees and commissions, custodian charges, interest expense, taxes, and auditing and legal expenses, are allocated to and paid by the company.

Management Services Agreement

The company and Assurant, Inc., maintain a management services agreement whereby Assurant, Inc., and its subsidiary companies provide various management services to the company. The services provided for under the agreement include the following:

(a) Risk management and provision of certain liability insurance coverages.
(b) Administration of employee benefit plans in which company personnel participate, including all monitoring, accounting, plan development, certain plan contributions, and servicing.

(c) Design, development, and administration of executive compensation programs and plan contributions.
(d) Centralized staff and support services, including internal and external audit, accounting, financial reporting, tax advice, preparation and review of tax returns, legal, human resources recruitment, employee training and development, special or unique actuarial, and management consulting.
(e) Advice regarding strategic and operational matters, assistance in developing business plans and budgets, general asset and liability management, advice regarding risk-based and other capital systems.
(f) Advertising, marketing, public relations and government affairs services.
(g) Rating agency coordination.

The company pays an annual fee for services equal to the company's allocated portion of Assurant, Inc.'s net allocable operating expenses for the year, determined by Assurant, Inc., based on appropriate and rational allocation methods that are in conformity with customary insurance accounting practices.

Administrative Services Agreement

The company is party to a services agreement with FBIC for the provision of administrative and other services relating to FIC group dental insurance coverages. Services performed by FBIC include claim processing and payment, policyholder services, maintenance of records, daily preparation of claim disbursements, and maintenance of a toll-free 800 telephone number for customer calls. The agreement requires that FIC pay to FBIC a monthly capitation fee plus an hourly consulting fee at scheduled rates if FBIC performs certain types of consultant services upon the prior written request of the company. Settlement of balances due under the services agreement is performed monthly.

Discretionary Agency Agreement

The company is party to an agreement between Assurant, Inc., and certain of its affiliates and Marshall and Ilsley Trust Company (M&I) which establishes a securities lending facility on behalf of the Assurant, Inc., companies. The agreement appointed M&I as agent for the purpose of lending securities, and authorized M&I to conduct securities lending activities in accordance with standards established by the Assurant, Inc., lender companies. The agreement requires that, concurrent with borrower receipt of loaned securities, M&I will take delivery of collateral equal to 102% of the market value of the loaned securities plus accrued and unpaid interest and dividends. The agreement provides that M&I will perform a daily mark-to-market of loaned securities, and will perform all required ancillary services in support and maintenance of the securities lending activity.

V. REINSURANCE

The company's reinsurance portfolio and strategy are described below. The contracts contain proper insolvency provisions.

Ceded Reinsurance Agreements

<u>50% Ceded Coinsurance—Individual and Group Medical Insurance</u>

The company has established reinsurance agreements with three reinsurers whereby the company recognizes cession of an aggregate of 50% coinsurance on its individual and group health insurance policies. Examination review determined that although coinsurance in form, the reinsurance treaties function as stop-loss reinsurance and not as proportional reinsurance. Further description of the contracts is included in the examination findings section of this report captioned “Reinsurance Contracts.”

<u>100% Ceded Coinsurance and Reinsurance Assumption—Medicare Supplement Insurance</u>

Effective July 13, 1998, the company entered into a coinsurance agreement and assumption reinsurance agreement with United Teacher Associates Insurance Company (UTAIC) for the sale, transfer and assumption of FIC’s liability for Medicare supplement insurance policies. UTAIC assumed responsibility for 100% of the reserves and insurance liability for the subject policies. As of the date that UTAIC could satisfy assumption reinsurance criteria in each applicable state jurisdiction, FIC sold, ceded, and transferred to UTAIC by way of assumption reinsurance all of the company’s rights and obligations under the coinsured policies. The company ceded $3.3 million of premium under the agreement in 2003.

<u>100% Ceded Coinsurance—Long-Term Care Insurance</u>

Effective March 1, 2000, the company established a reinsurance agreement with John Hancock Life Insurance Company (John Hancock) whereby the company transferred to John Hancock all of the company’s liability for long-term care insurance policies. The agreement is structured as a sale of the business line, and provides for FIC cession of risks to John Hancock on a 100% coinsurance basis. John Hancock is the administrator of the business. The 2000 transaction resulted in an after-tax gain of $100.8 million to the company, which is deferred and was recorded by the company as unrealized gain. The unrealized gain is amortized into income in future accounting periods as maturing policies terminate and are removed from the book of business, thereby releasing FIC's contingent liability as the original issuer of the business. In 2003, the company recognized amortized gains of $8.2 million, and ceded $98.6 of premiums and $591.9 million of reserves to John Hancock pursuant to the reinsurance agreement.

100% Ceded Coinsurance—Individual Life and Annuity Insurance

Effective April 1, 2001, the company entered into a reinsurance agreement with Hartford Life Insurance and Annuity Company (Hartford) for the transfer to Hartford of business comprised of certain individual life insurance policies and annuity business written by the company. The agreement is structured as a sale of the business line, and provides for FIC cession of risks to Hartford on a 100% coinsurance basis. Hartford is the administrator of the business. The 2001 transaction resulted in an after-tax gain of $121.8 million to the company, which is deferred and was recorded by the company as unrealized gain. The unrealized gain is amortized into income in future accounting periods as maturing policies terminate and are removed from the book of business, thereby releasing FIC's contingent liability as the original issuer of the business. In 2003, the company recognized amortized gains of $9.6 million, and ceded $61.5 of premiums and $616 million of reserves to Hartford pursuant to the reinsurance agreement.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner in the December 31, 2003, annual statement. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Fortis Insurance Company
Assets
As of December 31, 2003

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$606,844,952	$	$606,844,952
Stocks:			
Preferred stocks	26,630,598		26,630,598
Mortgage loans on real estate:			
First liens	41,949,087		41,949,087
Real estate:			
Occupied by the company	18,575,108		18,575,108
Held for production of income	662,205		662,205
Held for sale	265,641		265,641
Cash	(26,871,153)		(26,871,153)
Short-term investments	10,858,693	24,970	10,833,723
Contract loans	103,287		103,287
Other invested assets	1,267,910		1,267,910
Receivable for securities	14,375		14,375
Investment income due and accrued	7,525,031		7,525,031
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	5,436,843		5,436,843
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	20,454		20,454
Reinsurance:			
Amounts recoverable from reinsurers	332,253		332,253
Net deferred tax asset	38,496,996	8,723,009	29,773,987
Guaranty funds receivable or on deposit	3,486,170		3,486,170
Furniture and equipment, including health care delivery assets	35,824	35,824	
Receivable from parent, subsidiaries and affiliates	7,313,497		7,313,497
Health care and other amounts receivable	33,367,521	31,922,054	1,445,467
Write-ins for other than invested assets:			
Prepaid assets	1,680,558	1,680,558	
Amounts due from outside parties	988,259	112,388	875,871
Total Assets	$778,984,109	$42,498,803	$736,485,306

Fortis Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2003

Aggregate reserve for life contracts		$ 1,433,003
Aggregate reserve for accident and health contracts		94,683,192
Liability for deposit-type contracts		42,936,035
Contract claims:		
Life		236,648
Accident and health		103,679,733
Premiums and annuity considerations received in advance		15,945,268
Contract liabilities not included elsewhere:		
Other amounts payable on reinsurance		294,629
Interest maintenance reserve		3,611,026
Commissions to agents due or accrued		5,878,712
General expenses due or accrued		63,657,474
Taxes, licenses, and fees due or accrued, excluding federal income taxes		11,981,446
Current federal and foreign income taxes		11,682,381
Unearned investment income		30
Amounts withheld or retained by company as agent or trustee		18,248,733
Amounts held for agents' account, including agents' credit balances		6,074,216
Remittances and items not allocated		5,353,248
Liability for benefits for employees and agents if not included above		154,703
Miscellaneous liabilities:		
Asset valuation reserve		4,961,471
Payable to parent, subsidiaries and affiliates		39,550,219
Funds held under coinsurance		126,322,804
Payable for securities		4,078,042
Total Liabilities		560,763,013
Common capital stock	$ 2,500,000	
Gross paid in and contributed surplus	310,654,839	
Unassigned funds (surplus)	(137,432,546)	
Total Capital and Surplus		175,722,293
Total Liabilities, Capital and Surplus		$736,485,306

Fortis Insurance Company
Summary of Operations
For the Year 2003

Premiums and annuity considerations for life and accident and health contracts		$560,030,964
Net investment income		21,886,833
Amortization of interest maintenance reserve		308,104
Commissions and expense allowances on reinsurance ceded		144,350,794
Write-ins for miscellaneous income:		
Experience refund		125,685,558
Fee income		14,650,357
Miscellaneous		5,422,649
Total income items		872,335,259
Death benefits	$ 882,610	
Disability benefits and benefits under accident and health contracts	321,562,803	
Surrender benefits and withdrawals for life contracts	13,090	
Interest and adjustments on contract or deposit-type contract funds	1,661,525	
Increase in aggregate reserves for life and accident and health contracts	15,095,018	
Subtotal	339,215,046	
Commissions on premiums, annuity considerations, and deposit-type contract funds (direct business only)	149,626,500	
General insurance expenses	216,388,309	
Insurance taxes, licenses, and fees excluding federal income taxes	25,957,510	
Increase in loading on deferred and uncollected premiums	(322)	
Total deductions		731,187,043
Net gain from operations before federal income taxes		141,148,216
Federal income taxes incurred (excluding tax on capital gains)		45,581,350
Net gain from operations after federal income taxes and before realized capital gains or losses		95,566,866
Net realized capital losses, less capital gains tax		(642,371)
Net Income		$ 94,924,495

Fortis Insurance Company
Cash Flow
For the Year 2003

Premiums collected net of reinsurance			$ 546,406,092
Net investment income			23,146,102
Miscellaneous income			272,329,879
Total			841,882,073
Benefits and loss-related payments		$300,364,408	
Commissions, expenses paid, and aggregate write-ins for deductions		385,185,771	
Federal and foreign income taxes paid		41,133,328	
Total deductions			726,683,507
Net cash from operations			115,198,566
Proceeds from investments sold, matured, or repaid:			
Bonds	$160,727,163		
Stocks	6,311,898		
Mortgage loans	1,841,386		
Real estate	11,153		
Other invested assets	32,190		
Miscellaneous proceeds	1,254,484		
Total investment proceeds		170,178,274	
Cost of investments acquired (long-term only):			
Bonds	306,583,220		
Stocks	21,342,751		
Mortgage loans	21,400,000		
Other invested assets	872,171		
Miscellaneous applications	1,300,003		
Total investments acquired		351,498,145	
Net decrease in policy loans and premium notes		(28,199)	
Net cash from investments			(181,291,672)
Cash from financing and miscellaneous sources:			
Net deposits on deposit-type contracts and other insurance liabilities		(1,288,329)	
Dividends to stockholders		(36,000,000)	
Other cash provided		41,782,682	
Net cash from financing and miscellaneous sources			4,494,353
Reconciliation			
Net change in cash and short-term investments			(61,598,753)
Cash and short-term investments, December 31, 2002			45,561,323
Cash and short-term investments, December 31, 2003			$ (16,037,430)

Fortis Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2003

Assets			$736,485,306
Less liabilities			560,763,013
Adjusted surplus			175,722,293
Annual premium:			
Individual life and health	$209,763,590		
Factor	15%		
Total		$31,464,539	
Group life and health	336,642,503		
Factor	10%		
Total		33,664,250	
Greater of 7.5% of consideration or 2% of reserves for annuities and deposit administration funds		2,475,441	
Compulsory surplus (subject to a $2,000,000 minimum)			67,604,230
Compulsory surplus excess			$108,118,063
Adjusted surplus (from above)			$175,722,293
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum of 110%)			83,153,202
Security surplus excess			$92,569,091

Fortis Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of total capital and surplus during the period under examination as reported by the company in its filed annual statements:

	2003	**2002**	**2001**	**2000**	**1999**
Capital and surplus, beginning of year	$140,573,478	$124,295,381	$124,969,531	$141,096,783	$743,582,330
Net income	94,924,495	63,609,395	48,358,002	71,251,852	1,486,912
Change in net unrealized capital gains or (losses)	26,089	(5,639)	584,480	(7,748,296)	(4,681,893)
Change in net deferred income tax	3,562,205	6,073,986	(18,159,675)		
Change in nonadmitted assets and related items	(8,802,207)	(10,696,137)	6,532,343	3,505,080	197,167
Change in reserve on account of change in valuation bases					14,135,204
Change in asset valuation reserve	(782,288)	2,783,808	11,092,476	3,909,299	114,349
Cumulative effect of changes in accounting principles			20,746,000		
Capital changes:					
Paid in				(116,766)	
Surplus adjustments:					
Paid in				(184,883,234)	
Transferred to capital					(533,737,286)
Change in surplus as a result of reinsurance	(17,779,479)	(20,487,316)	100,172,224	97,954,813	
Dividends to stockholders	(36,000,000)	(25,000,000)	(170,000,000)		(80,000,000)
Capital and surplus, end of year	$175,722,293	$140,573,478	$124,295,381	$124,969,531	$141,096,783

Fortis Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2003

The company's NAIC Insurance Regulatory Information System results for the years under examination are summarized in the following table. The unusual IRIS results during the period are denoted with asterisks, and are discussed following the table of IRIS data.

	Ratio	**2003**	**2002**	**2001**	**2000**	**1999**
#1	Net change in capital & surplus	25%	13%	(1)%	120% *	(81)% *
#2	Gross change capital & surplus	25	13	(1)	(11) *	(81) *
#3	Net income to total income	11	9	124	15	0 *
#4	Comm. and Exp to Prem. and Deposits			Discontinued		
#5	Adequacy of investment income	999 *	999 *	124 *	202	240
#6	Nonadmitted to admitted assets	6	5	4	1	1
#7	Total real estate & mortgage loans to cash & invested assets	9	8	8	15	18
#8	Total affl. investments to capital & surplus	4	9	10	17	22
#9	Surplus relief	72 *	78 *	208 *	182 *	52 *
#10	Change in premium	13	999 *	(99) *	(62) *	(39) *
#11	Change in product mix	1.4	0	0	10 *	2
#12	Change in asset mix	1.6	1	3	1	4
#13	Change in reserving ratio	(35) *	35 *	0	(16)	(8)

The IRIS ratio data indicated above reflect financial information reported by the company that include the financial effects of the company's 50% coinsurance reinsurance, including the effect of ceded premiums and losses reported by the company. IRIS ratio results that directly relate to the company's recognition of the 50% coinsurance include the unusual result for ratio #10, Change in Premium, in 1999 and the unusual results for ratio #9, Surplus Relief, in each of the years under examination. The examination determined that the 50% coinsurance treaties function as stop-loss reinsurance, and are proportional reinsurance in form only. Further examination discussion pertaining to the 50% coinsurance agreements is included in the findings section of this report captioned "Reinsurance Contracts."

IRIS ratios #1 and #2 analyze, respectively, the percentage change year-to-year in net and gross capital and surplus. The unusual results for ratio #1 and ratio #2 in 1999 were due to payment of an $80 million dividend to the company's sole shareholder. The unusual result for ratio #1 in 2000 was due to reported net income of $71 million in 2000. The unusual result for ratio #2 in 2000 was due to the redemption of FIC preferred stock and surplus paid in to Fortis, Inc., of $185 million.

The unusual result for ratio #5, Adequacy of Investment Income, in 2001 was due to the company's entry into a reinsurance agreement with Hartford for the sale of the company's individual life insurance and annuity business and the corresponding decrease in the company's invested assets. The unusual result for ratio #5 in 2002 and 2003 were due to the nature of the company's ongoing accident and health insurance business for which earned investment income exceeds interest credited to policyholders.

The unusual result for ratio #10, Change in Premium, in 2000 was due to the company's establishment of a reinsurance agreement with John Hancock for 100% coinsurance cession and sale of the company's long-term care insurance policies and the corresponding decrease in FIC net premiums written. The unusual results for ratio #10 in 2001 was due to the company's entry into the 2001 reinsurance agreement with Hartford for 100% coinsurance and sale of the company's individual life insurance and annuity business, and the corresponding decrease in FIC net premium written.

The unusual result for ratio #13, Change in Reserving Ratio, in 2002 was due to the calculation results in the 2001 statutory annual statement Analysis of Assets and Exhibit 1 that relate to the 2001 100% coinsurance reinsurance cession due to Hartford. The unusual result for ratio #13 in 2003 was due to the runoff of the company's life insurance and annuity business as a result of the 2001 reinsurance agreement.

Growth of Fortis Insurance Company

Year	Admitted Assets	Liabilities	Surplus
2003	$ 736,485,306	$ 560,763,013	$175,722,293
2002	617,737,602	477,164,124	138,073,478
2001	594,091,973	469,796,592	121,795,381
2000	1,098,181,900	973,212,369	122,469,531
1999	1,433,095,862	1,291,999,079	138,480,017
1998	1,908,405,756	1,164,823,426	740,965,564

Life Insurance In Force (in thousands)

Year	Gross Risk In Force	Ceded	Net
2003	$ 9,976,690	$ 9,441,312	$ 565,378
2002	10,728,509	10,197,496	531,013
2001	11,658,547	11,170,024	488,523
2000	13,649,837	1,886,876	11,762,961
1999	15,594,343	2,131,706	13,462,637
1998	16,925,975	2,503,098	14,422,877

Accident and Health

Year	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Other Expenses Incurred	Combined Loss and Expense Ratio
2003	$544,331,459	$328,554,291	$14,682,556	$242,797,254	107.2%
2002	456,657,182	280,848,698	18,649,881	230,949,312	116.2
2001	383,711,225	253,103,619	(4,441,649)	173,511,831	110.1
2000	110,413,181	205,758,025	(20,631,113)	159,965,624	312.6
1999	391,117,433	253,858,889	41,176,921	172,976,337	119.7
1998	684,146,189	421,653,229	93,885,937	193,014,937	103.5

The above historical financial data as reported by the company includes the financial effects of the company's 50% coinsurance agreements, including the effect of ceded premiums and losses reported by the company. The examination determined that the 50% coinsurance agreements operate as stop-loss reinsurance contracts, and are not proportional reinsurance. In 2003, the company reported ceded premiums of $559,943,563 and ceded loss reserves of $126,322,804 under the disallowed reinsurance accounting treatment. Further examination discussion pertaining to the 50% coinsurance agreements is included in the findings section of this report captioned "Reinsurance Contracts."

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus between that reported by the company and as determined by this examination:

	Increase	Decrease	
Surplus December 31, 2003, per annual statement			$175,722,293
Agents' credit balances liability	$1,946,946	$	
Net increase or (decrease)	$1,946,946	$ 0	1,946,946
Surplus December 31, 2003, per examination			$177,669,239

Examination Reclassifications

	Debit	Credit
Funds held under reinsurance	$126,322,804	$
Aggregate reserve for accident and health contracts		126,322,804
Total reclassifications	$126,322,804	$126,322,804

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were sixteen specific comments and recommendations in the previous examination report. Comments and recommendations contained in the previous examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company file biographical information for newly appointed officers and directors with the Commissioner within 15 days after their appointment, as required by s. Ins 6.52 (5), Wis. Adm. Code.

   Action—Noncompliance. Further comment and recommendation is located in the findings section of this report captioned "Biographical Disclosures."

2. Management and Control—It is recommended that the company maintain adequate documentation from one examination to the next to evidence its compliance with the Commissioner's directive on conflict of interest questionnaires.

   Action—Compliance.

3. Management and Control—In order to formally document the board's review of the company's operations and the actions taken by the officers, it is recommended that the board or the sole shareholder, at least annually, acknowledge the operations of the company and approve the actions taken by the officers during the period.

   Action—Compliance.

4. Management and Control—It is recommended that the company document compliance with its by-laws concerning the annual election of directors.

   Action—Compliance.

5. Accounts and Records—It is recommended that the company comply with s. Ins 6.80 (4), Wis. Adm. Code, and maintain detailed operating and financial records for a minimum of three years.

   Action—Compliance.

6. Accounts and Records—It is recommended that the company prepare a master listing and maintain an up-to-date reconciliation of its reinsurance agreements.

   Action—Compliance.

7. Investments—Therefore, it is again recommended that the company update its custodial agreement to provide for the necessary safeguards as outlined in the NAIC Financial Condition Examiners Handbook.

   Action—Compliance.

8. Investments—It is recommended that the company follow the NAIC Annual Statement Instructions—Life, Accident and Health, and only report those securities with maturity dates of one year or less at the time of purchase on Schedule DA in future statutory statement filings.

Action—Compliance.

9. Investments—It is recommended that the company regularly obtain audited financial statements for valuing its Other Invested Assets.

   Action—Compliance.

10. Real Estate—It is recommended that the company properly complete Schedule A in future statutory statement filings, in accordance with NAIC guidance.

    Action—Compliance.

11. Affiliated Balances—It is again recommended that the company discontinue offsetting affiliated payables to one company with receivables from another affiliate in accordance with statutory accounting principles.

    Action—Compliance.

12. Affiliated Balances—It is recommended that the company develop documentation to support all affiliated transactions, and how the charges are to be calculated.

    Action—Compliance.

13. Federal Income Taxes—It is recommended that the company:

    a. reflect the annual statement caption for federal income tax recoverable as “Federal Income Tax Recoverable—Parent,”

    b. obtain documentation to substantiate that “liabilities which offset the related intercompany receivables are established by other companies participating in the consolidated tax return,”

    c. require timely settlement of balances as required by the intercompany tax allocation agreement.

    Action—Compliance.

14. Premium—It is again recommended that the company eliminate outstanding items from the suspense account balances on a timely basis, within three months.

    Action—Noncompliance. Current examination comment and recommendation is included in the findings section of this report captioned “Premium Suspense Controls and Financial Reporting.”

15. Compulsory and Security Surplus—It is recommended that the company properly complete the Compulsory and Security Surplus Calculation in future statutory statement filings.

    Action—Compliance.

16. Information Technology—It is recommended that the company update the “Cold Site Facilities” contract with Datashield to reflect the name change of the company from Time to Fortis Insurance Company.

    Action—Compliance.

Summary of Current Examination Results

Biographical Disclosures

Pursuant to s. Ins 6.25 (5), Wis. Adm. Code, an insurer is required to file biographical disclosures for newly appointed or elected directors and executive officers within 15 days following their appointment or election. The company appointed one new senior executive officer and one new director during the examination period, for whom the company did not file required biographical information. The previous examination also determined that the company was not in compliance with the requirement to file biographical disclosures. It is again recommended that the company file biographical information for newly appointed officers and directors within 15 days of their appointment, in compliance with the requirement of s. Ins 6.25 (5), Wis. Adm. Code.

Holding Company Disclosure

The company formed a new wholly owned subsidiary, National Insurance Institute, LLC (NII), effective August 11, 2004. NII was established as a Wisconsin-domiciled limited liability company to conduct market surveys and research.

Pursuant to s. 611.26 (5), Wis. Stat., and s. Ins 40.14 (2), Wis. Adm. Code, an insurer shall provide to the Commissioner prompt notification upon the formation or acquisition of a subsidiary. The company did not provide the required notification upon its formation of NII. It is recommended that the company comply with the holding company notification requirements establish by s. 611.26 (5), Wis. Stat., and s. Ins 40.14 (2), Wis. Adm. Code.

Financial Reporting—Executive Compensation

Section 611.63 (4), Wis. Stat., and Wisconsin's statutory annual statement instructions require that an insurer file a Report on Executive Compensation as a supplement to the insurer's statutory annual financial statements. The Report on Executive Compensation is a three-part form in which an insurer is to provide detailed information regarding individual officer and employee compensation, individual directors' compensation, and total aggregate annual compensation. The company completed Part 1 of the 2003 Report on Executive Compensation but did not report information for Part 2 or Part 3. It is recommended that the company complete and file detailed disclosure for each of the separate parts of the Report on Executive

Compensation, in compliance with Wisconsin statutory financial statement instructions and s. 611.63 (4), Wis. Stat.

Reinsurance Contracts

Fortis Insurance Company and John Alden Life Insurance Company have each entered into reinsurance agreements which are written as 50% coinsurance on a funds-withheld basis, and cede approximately 50% of the companies' accident and health premiums and associated life coverages to reinsurers indicated in the table below. As funds-withheld agreements, all of the assets and liabilities remain with the ceding insurers.

2003 Business	**FIC**		**JALIC**	
	Reins %	Premium Ceded	Reins %	Premium Ceded
Generali USA Life Reassurance Co.	10	$111,988,713	6	$ 38,624,019
The Manufacturer's Life Ins. Co. (USA)	20	223,977,425	17	173,808,085
London Life Reinsurance Co.	20	223,977,425	27	109,434,721
Total	50	$559,943,563	50	$321,866,825
Expense and Profit Charge		$ 3,231,434		$ 1,953,571

The contracts establish a target combined ratio of 94%. In the event that the combined ratio is 98% for any three-month period, or 96% for any six-month period, or 94% for any twelve-month period, revised premiums would be implemented by the company as soon as practical to achieve the targeted combined ratio.

The following table lists the combined ratios reported on the reinsurance agreements for the past five years. The amount reported for 2004 is a rolling twelve-month ratio through September.

	Fortis	**John Alden**
2000	89.3%	96.7%
2001	85.1	87.6
2002	79.3	83.1
2003	78.2	83.9
2004	71.2	78.2

The reinsurance agreements have an experience refund which returns all of the profits less an expense and profit charge based on premiums ceded of .58% for FIC and .61% for

JALIC as long as the combined ratio on the business ceded is less than 98%. For combined ratios between 98% and 100% the profit commission is reduced so that the ceding company and the reinsurers share the profits equally. Coverage under the agreements is provided by the reinsurers when the combined ratio is between 100% and 110% where the reinsurers would pay their participating share (50%) of the losses and expenses. A separate stop-loss premium of .5% of premium ceded is paid by the reinsurers to FIC and JALIC as compensation for the 110% cap on coverage. FIC and JALIC report this stop-loss premium as reinsurance assumed on their annual statements, even though the subject premium being assumed is on policies directly written by FIC and JALIC and separate assumption reinsurance agreements were not established.

The companies each reported the experience refund as miscellaneous income in the Summary of Operations. The following table represents the experience refunds reported in the companies' financial statements on business reinsured. The amounts reported for 2004 was through September 30.

	FIC	**JALIC**
2000	$ 46,021,055	$18,467,117
2001	61,952,355	41,628,576
2002	100,659,099	51,808,739
2003	125,685,558	53,662,335
2004	129,999,563	44,972,018

In the event that the experience refund for any period is negative, it is carried forward at interest until it is paid back through future profits. It appears, depending on the method of termination, that payment for a negative profit commission would be due from FIC and JALIC to the reinsurers.

Risk transfer under the agreements occurs at a 98% combined ratio. Coverage is limited to when the combined ratio is between 100% and 110%. Considering that the combined ratio of the block of business is significantly less than the point at which the reinsurers would participate and that there are provisions in the agreements which address higher loss ratios with rate increases, it is questionable whether the contracts transfer any significant amount of risk. In addition, the contracts cede 50% of the premium to provide coverage for 5% (half of the range between 100% and 110%) of the losses. The agreements in practice work more like a stop-loss agreement than coinsurance. The benefit of the agreements being structured as coinsurance agreements rather than a stop-loss agreement is that FIC and JALIC significantly reduce their reported net premium which results in lower required capital for Risk Based Capital and Compulsory and Security Surplus as required by s. 623.11 and s. 623.12, Wis. Stat., and s. Ins 51.80, Wis. Adm. Code. The reinsurance agreements do not misstate total liabilities or surplus since the reserve credit taken for the 50% coinsurance is offset by the additional liability "Funds held under coinsurance."

SSAP 61 Life Deposit Type and Accident and Health Reinsurance and FASB Statement 113 Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts address reinsurance agreements. SSAP 61 indicates that FASB Section 113 is adopted with modification. None of the seven modifications listed in SSAP 61 include differences between GAAP and statutory accounting with regard to the standards for evaluating reinsurance transfer of risk, and the guidance in FASB Statement 113 is applicable to evaluating the 50% coinsurance agreements.

FASB Section 113 requires that 1) the reinsurer assume significant insurance risk under the assumed portions of the underlying contracts, and 2) it must be reasonably possible that the assuming entity may realize a significant loss. The company provided an analysis performed by their auditors at the time of entering into the agreements.

For the first test, it was indicated that the requirements do not require an exact correlation of results, but some correlation is expected. The analysis determined if the treaties were treated as a stop-loss treaty, once the combined ratio exceeded 100%, the reinsurer would share in the losses, thus meeting the requirement. For the second test, it was indicated that the reinsurer could incur a significant loss at a combined ratio of 110%, their maximum exposure. (This is becoming increasingly unlikely as the table above has shown combined ratio has significantly decreased in the past four years.)

The possible scenario identified is that the combined ratio would spike in the last quarter of the year and there would be not enough time to take remedial action on the premium rates to address the increased loss history. (This does not address the fact that the negative result is used as a carry-forward amount in determining future experience refunds.) It was also indicated that the reinsurers would likely cancel the contracts if the combined ratio got closer to 100%. The ultimate conclusion is that for GAAP purposes, the agreements would qualify for reinsurance accounting under FASB Statement 113 only as stop-loss and that only the expense and profit charge should be recognized as the ceded premium. Analysis indicated that the only impact to surplus is the expense and profit charge. The company has reported the reinsurance as stop-loss on its GAAP statements but as proportional coinsurance on its statutory statements.

The examiners' review as well the company auditor's GAAP basis analysis document that the economic substance of the 50% coinsurance agreement is much more closely aligned with that of an excess of loss reinsurance agreement. Therefore, the examination does not consider agreements to be 50% coinsurance.

As a result of the disallowance of the company's accounting treatment for the 50% coinsurance agreements, the examination found that the company misclassified $126,322,798 "Aggregate reserve for accident and health contracts" as the liability for "Funds held under coinsurance." The misclassification did not change total liabilities or capital and surplus.

As noted above, the agreements provide significant premium leverage which affects capital requirements, as shown in the following table. The pro-forma Risk Based Capital amount is an estimation of the actual amount as it may not have considered all of the changes that retaining the ceded premium would have affected. In neither case would it result in FIC or JALIC failing Compulsory Surplus or being at a Risk Based Capital action level.

Risk Based Capital as a Percentage of Authorized Control Level

	FIC	**JALIC**
Risk Based Capital as Filed	800%	1,013%
Pro-Forma Risk Based Capital	486	769
Excess Compulsory Surplus as Filed	$67,604,228	$98,250,398
Pro-Forma Excess Compulsory Surplus	41,714,980	65,337,482

In December 2004, FIC and JALIC terminated their 50% coinsurance agreements effective December 31, 2004. Due to the termination of the agreements subsequent to examination fieldwork, the examination did not make a recommendation regarding the agreements.

Premium Receivable Estimation Methodology

Examination of FIC premium receivable accounting determined that the company is currently using an inadequate premium receivable estimation model. Year-end 2003 adjusted gross premium accruals required an adjustment for a data system calculation error identified by the company in 2000. The system problem relates to accrual software that causes error by counting adjustments made to premium due accounts for terminated policies, prior-period adjustments, multiple billings, and billings over 90 days past due as multiple due premiums. The error is apparently increased by higher re-rate activity, as more premiums are subject to adjustments to reflect frequent changes of benefits in insured policies.

FIC uses a computer application which isolates policies having more than $2,500 of accrued premium and adjusts those large premium accrual accounts to compensate for excess accruals. The company's current practice is used as a temporary fix in an effort to identify and make adjustment for the majority of the accrual error. The company has developed a new data warehouse system enhancement which is intended to correct the observed data system problem going forward. Reporting based on the new system tentatively indicated that premium due reported at year-end 2003 was likely understated conservatively by some $125,000.

FIC also adjusts premium due accruals for collectibility based on experience trends, and currently uses an across the board adjustment of 43% of adjusted gross premiums due, net of reductions for the above-described data system corrections and additional adjustments to nonadmit premiums greater than 90 days. The 43% adjustment factor is based on 1997 to1999 premium billing averages as analyzed in 2000.

It is recommended that the company develop and implement data system changes so as to eliminate the current system calculation errors for adjustments made to premium due accounts, and to accurately model premium receivable accruals. It is further recommended that the company perform current-period analysis of premium billings to model account collectibility trends and to establish updated collectibility calculations.

Premium Suspense Controls and Financial Reporting

Examination of FIC premium suspense monitoring and reporting procedures identified a number of control weaknesses. It was noted that, as of year-end 2003, accounting controls did not include provisions for the following:

1) System reporting of aged suspense items analysis.
2) System reporting of higher risk aged items more than 90 days outstanding.
3) Monitoring of aged items more than 90 days outstanding to assess the reasonableness of potentially higher risk stale item settlements.
4) Identification and monitoring of large dollar items to assess the reasonableness of potentially higher risk items based on dollar exposure.

Examination of suspense reconciliations noted that, in the first quarter of 2004, the company wrote off several hundred suspense items totaling approximately $161,000 related to items dating from 1992 through the third quarter of 2003. Company personnel indicated that premium suspense data system enhancements are under development and have been in testing since 2003, and are intended to address that above-noted deficiencies in procedural controls. As of the time of examination fieldwork, these reporting enhancements have not yet been formally implemented.

It is recommended that the company:

1) Complete its testing and formally implement system reporting enhancements to provide for analysis and reporting of aged items.

2) Develop and implement a formal procedure for using the system reporting enhancements to provide for independent monitoring of the reasonableness of aged suspense items that are more than 90 days outstanding or that represent high dollar risk exposure.

3) Develop procedures to monitor and write-off in a timely manner aged suspense items that are deemed to be uncollectible.

Home Office Agents' Credit Balance Status

The company's reported liability for agents' credit balances included home office accounts of $1,946,146 that should not have been included in the company's year-end liability. The overstated liability represents calculated agent credit amounts on accounts that were initially established as agent of record for internal accounting purposes relating to the introduction of particular insurance products. The corresponding agent account numbers were never properly classified as home office accounts, and thereafter the system calculated routine agent credit balances as if the accounts were actual agent accounts.

The examiners noted that some of the status errors for the home office accounts dated back for several years during which the home office accounts were improperly coded and processed as agent accounts. The examiners made a $1,946,126 debit adjustment to the company's agents' credit balances liability, and a corresponding credit adjustment to increase reported surplus to correct for the overstatement of liabilities. It is recommended that the company exclude home office accounts from its reported liability for agents' credit balances, and that the company implement agent credit balance procedural controls to monitor the status of home office versus agent accounts.

Financial Reporting—Real Estate

Examination review determined that in 2002 the company wrote down $2.1 million of home office real estate assets, but subsequently neglected to deduct the assets from real estate cost reported in Schedule A of its statutory annual statement. In addition, in 2002 and 2003 real estate costs reported in Schedule A included $1,049,715 of leasehold improvements that should have been excluded from reported cost pursuant to SSAP 19 paragraph (5). The two errors resulted in a $3.1 million aggregate overstatement of Schedule A real estate cost in 2002 and 2003, but did not result in misstatement of net admitted real estate assets.

Company management indicated that it is aware of the observed errors and will correct the errors going forward. It is recommended that the company correctly report financial data in the exhibits of its statutory annual statement in compliance with <u>NAIC Quarterly and Annual Statement Instructions Life, Accident and Health</u>.

VIII. CONCLUSION

Fortis Insurance Company is a stock life insurance company that principally markets accident and health insurance for individual and small group medical coverages. During the period under examination, the company exited the markets for long-term care insurance and individual life insurance and annuities by ceding its existing policies in those business lines through 100% coinsurance reinsurance treaties.

The examination determined that the company's 50% coinsurance reinsurance agreements for accident and health policies transfer risk on the basis of stop-loss provisions and are not proportional in nature. The company's accounting recognition of the reinsurance agreements as 50% coinsurance resulted in understatement of net premiums written and therefore misstated Risk Based Capital and minimum required capital and surplus calculations during each of the years under examination. The examination determined RBC at December 31, 2003, was 486% of authorized control level instead of the 800% of authorized control level reported. The examination reclassified $126,322,804 from "Funds held under coinsurance" to "Aggregate reserve for accident and health contracts." The company continues to exceed the minimum capital and surplus requirements and RBC requirements after the examination results. The company terminated the 50% coinsurance treaties effective December 31, 2004, and the examination did not make a recommendation regarding the agreements.

The examination determined that the company is not in full compliance with two of the recommendations of the previous examination, and those recommendations are repeated by the current examination. The current examination resulted in seven recommendations, summarized in Section IX of this report.

The examination noted one difference to accounts that resulted in a net increase in surplus per examination of $1,946,946. The examination determined that, as of December 31, 2003, the company's total admitted assets per examination were $736,485,306, total liabilities per examination were $558,816,067, and policyholders' surplus per examination was $177,669,239.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 31 - Biographical Disclosures—It is again recommended that the company file biographical information for newly appointed officers and directors within 15 days of their election or appointment, in compliance with the requirement of s. Ins 6.25 (5), Wis. Adm. Code.

2. Page 31 - Holding Company Disclosure—It is recommended that the company comply with the holding company notification requirements establish by s. 611.26 (5), Wis. Stat., and s. Ins 40.14 (2), Wis. Adm. Code.

3. Page 31 - Financial Reporting—Executive Compensation—It is recommended that the company complete and file detailed disclosure for each of the separate parts of the Report on Executive Compensation, in compliance with Wisconsin statutory financial statement instructions and s. 611.63 (4), Wis. Stat.

4. Page 36 - Premium Receivable Estimation Methodology—It is recommended that the company develop and implement data system changes so as to eliminate the current system calculation errors for adjustments made to premium due accounts, and to accurately model premium receivable accruals. It is further recommended that the company perform current-period analysis of premium billings to model account collectibility trends and to establish updated collectibility calculations.

5. Page 37 - Premium Suspense Controls and Financial Reporting**—**It is recommended that the company:

   1) Complete its testing and formally implement system reporting enhancements to provide for analysis and reporting of aged items.

   2) Develop and implement a formal procedure for using the system reporting enhancements to provide for independent monitoring of the reasonableness of aged suspense items that are more than 90 days outstanding or that represent high dollar risk exposure.

   3) Develop procedures to monitor and write-off in a timely manner aged suspense items that are deemed to be uncollectible.

6. Page 38 - Home Office Agents' Credit Balance Status**—**It is recommended that the company exclude home office accounts from its reported liability for agents' credit balances, and that the company implement agent credit balance procedural controls to monitor the status of home office versus agent accounts.

7. Page 38 - Financial Reporting—Real Estate**—**It is recommended that the company correctly report financial data in the exhibits of its statutory annual statement in compliance with NAIC Quarterly and Annual Statement Instructions Life, Accident and Health.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Jerry C. DeArmond	Policy and Claim Reserve Specialist
Randy Milquet	Data Processing Audit Specialist
Tim Vande-Hey	Data Processing Audit Specialist
Tom Janke	Insurance Financial Examiner
Russell L. Lamb	Insurance Financial Examiner
Carina Toselli	Insurance Financial Examiner
Thomas W. Thomas	Insurance Financial Examiner

Respectfully submitted,

Thomas E. Rust
Examiner-in-Charge